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Third Circuit Buyers Beware: District Court in Litman Holds Unconscionability Defense Contravened by Federal Arbitration Act

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Litman v. Cellco Partnership[1]

I. INTRODUCTION

Without even knowing it, just about everyone has agreed to settle disputes through arbitration and has waived any rights to proceed on a class-wide basis. While many consumers do not read the fine print in the agreements they sign, a variety of companies, from cell phone providers to car dealers, have consumers agree in sales contracts to arbitrate any claims and to waive the ability to proceed with a class action claim. This was the scenario in the case of *Litman v. Cellco Partnership*, in which a New Jersey federal district court held that the plaintiff cell phone customers could not use a state-law unconscionability defense to invalidate an agreement to arbitrate and a class action waiver, as the state law was preempted by federal legislation.[2] Unfortunately, this holding misinterpreted state and federal law, as evidenced by prior precedent and cases decided after the fact.[3] The holding also set an unfortunate precedent for consumers, stripping them of the only adequate remedy provided by law and subjecting them to a process that rarely rules in their favor.

II. FACTS AND HOLDING

Keith Litman and Robert Wachtel (Plaintiffs) were both Verizon Wireless customers in 2004.[4] At that time, both men paid a flat monthly rate for cell phone service.[5] They alleged that in October 2005, Verizon mailed a notice to all of its customers, stating that Verizon would begin assessing administrative charges to the monthly bill.[6]

1. No. 07-CV-4886(FLW), 2008 WL 4507573 (D.N.J. Sept. 29, 2008).
2. *Id.* at *6.
3. *See, e.g.*, Muhammad v. County Bank of Rehoboth Beach, 912 A.2d 88, 98-104 (N.J. 2006) (holding that state unconscionability defense can be used to invalidate an arbitration agreement that contained a class action waiver); Homa v. Am. Express, 558 F.3d 225 (3d Cir. 2009) (holding that the state unconscionability defense was not preempted by the FAA).
4. *Litman*, 2008 WL 5497573 at *1.
5. *Id.*
6. *Id.*

On October 7, 2007, both men filed a class action lawsuit against Verizon in New Jersey federal district court.[7] They alleged Verizon unlawfully assessed them and other customers an "'administrative charge' of $0.40 and/or $0.70," as part of their monthly phone bill.[8] Plaintiffs alleged that the charges were not part of their original service agreement and that nothing in the agreement authorized Verizon to implement such a charge.[9]

In 2004, Verizon's service agreement required Plaintiffs and Verizon to settle disputes by arbitration, except for certain small claims.[10] In 2005, Verizon amended its service agreement to state that "the Federal Arbitration Act applies to th[e] agreement" and the agreement "doesn't permit class arbitration."[11] The modified agreement further stated that "if for some reason the prohibition on class arbitrations . . . is deemed unenforceable, then the agreement to arbitrate will not apply."[12]

In response to Plaintiffs' suit, Verizon filed a motion to compel arbitration instead of an answer.[13] Even though the arbitration agreement was not in the Plaintiffs' original service agreement, Verizon claimed that their continued use of its services acted as an acceptance of the new agreement, and thus the Plaintiffs' claims should be arbitrated.[14] Plaintiffs claimed that the New Jersey Supreme Court held consumer contracts of adhesion that also require arbitration in low value claims to be unconscionable and unenforceable.[15] Verizon argued that the Federal Arbitration Act required its arbitration agreement to be held enforceable, and that the Third Circuit recently held that the FAA preempts state law that treats arbitration differently than other agreements.[16]

The U.S. District Court for the District of New Jersey noted that New Jersey state unconscionability law treats agreements to arbitrate differently than other contractual provisions.[17] Because of this unequal treatment, the court stated it was bound by section 2 of the FAA and by Third Circuit precedent in finding that the FAA preempted New Jersey state law.[18] Because the FAA controlled, the court held it could not rule the agreement unconscionable.[19]. Furthermore, the court held that the FAA required enforcement of a valid agreement to arbitrate; thus the court granted Verizon's motion to compel arbitration.[20]

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7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.* (alteration in original) (original was in all capital letters).
12. *Id.* (original was in all capital letters).
13. *Id.*
14. *See id.* at *1 n.2.
15. *Id.* at *2; *see* Muhammad v. County Bank of Rehoboth Beach, Del., 912 A.2d 88 (N.J. 2006).
16. *Litman*, 2008 WL 4507573, at *1, *2.
17. *Id.* at *5; *but see* Perry v. Thomas, 482 U.S. 483, 492 n.9 (stating a court may not construe arbitration agreements differently than non-arbitration agreements under state law).
18. *Id.* at *6 (citing Gay v. CreditInform, 511 F.3d 369, 393 (3d Cir. 2007).
19. *Id.* at *6 & n.6
20. *Id.* at *6-*7.

III. LEGAL BACKGROUND

A. Federal Arbitration Act

In 1925, Congress enacted the Federal Arbitration Act (FAA).[21] The act was created to combat the longstanding hostility towards arbitration that existed at English common law and in American courts; it sought to place agreements to arbitrate on the same footing as other contractual agreements.[22] Section 2 of the FAA states that arbitration agreements covered by the act "shall be valid, irrevocable and enforceable save upon grounds as exist at law or in equity for the revocation of any contract."[23] The Supreme Court has held that when Congress enacted section 2 of the FAA, it "declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."[24] As such, section 2 of the FAA creates a strong presumption in favor of arbitration, and the Court has also held that "any doubts concerning the scope of arbitrable issues should be resolved in the favor of arbitration."[25]

Southland Corp. v. Keating was an important U.S. Supreme Court case interpreting section 2 of the FAA.[26] In *Southland*, several franchisees entered into an agreement, containing an arbitration clause, with Southland to purchase 7-Eleven Stores.[27] One of the franchisees sued Southland for various claims, including a violation of the California Franchise Investment Law (FIL).[28] The Supreme Court of California held that the FIL violation claims were not arbitrable and that they were not preempted by the FAA.[29] The U.S. Supreme Court reversed the California court's decision.[30] The Court held that FIL claims were subject to arbitration because the FIL's requirement that claims receive a judicial determination was in conflict with the goals of the FAA and thus were preempted.[31]

This decision is pivotal to the court's interpretation of the FAA for two reasons. First, the decision explicitly states that the FAA is applicable in state courts, as well as federal courts.[32] The Court, based on the legislative history of the FAA, concluded that it was the intent of Congress to use the commerce clause to create a rule that would be applicable in state and federal courts in order to prevent state laws from undercutting the enforcement of arbitration agreements and undermining the goals of the FAA.[33]

The second reason this decision is important is that it reaffirms the notion that the FAA will preempt state laws that conflict with substantive law and the goals of

21. 9 U.S.C. §§ 1-16 (2006).
22. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991).
23. 9 U.S.C. § 2 (2006).
24. Southland Corp. v. Keating, 465 U.S. 1, 10 (1984).
25. Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp., 460 U.S. 1, 24-25 (1983).
26. *Southland*, 465 U.S. 1.
27. *Id.* at 4.
28. *Id.*
29. *Id.* at 5.
30. *Id.* at 17.
31. *Id.* at 16.
32. *Id.* at 12, 16.
33. *Id.* at 13-16.

the FAA.[34] While the FAA does not have any direct preemption provisions,[35] the FAA will preempt state law if the law specifically singles out arbitration, disfavors arbitration, or would require a judicial forum for an entire class of agreements.[36] That being said, generally applicable contract defenses, such as fraud, misrepresentation, duress, and unconscionability, may be applied to invalidate an agreement to arbitrate without contravening the FAA.[37] The defenses must be general defenses, though, meaning they must apply equally to agreements to arbitrate and those that don't involve arbitration.[38]

B. Third Circuit's Interpretation of the FAA

Since the subject of this note is a case based in the U.S. Court of Appeals for the Third Circuit,[39] the circuit's interpretation of the FAA bears great weight on the outcome of the case. At the time of the *Litman* decision, *Gay v. CreditInform* was the most recent and applicable example of how the Third Circuit interprets the FAA and applies it to state contract law.

Gay v. CreditInform[40] involved a plaintiff consumer who brought a class action suit in connection to a $39.92 charge she received after her purchase of credit repair services.[41] The defendant lender moved to compel arbitration, as was required by the parties' service agreement, which also contained a class action waiver.[42] The plaintiff argued that the class action waiver contained in the agreement was unconscionable under Pennsylvania law.[43] The Plaintiff cited two Pennsylvania appellate court decisions that held class action waivers contained in consumer contracts of adhesion were unconscionable and unenforceable.[44] The defendant argued that Virginia law should apply, as there was also a choice of law provision in the agreement.[45] The Court of Appeals for the Third Circuit, in affirming the ruling of the district court, ruled for the defendant.[46] The court found that Virginia law concerning unconscionability should apply, but it then held that

34. *See id.* at 16.

35. *See* 9 U.S.C. §§ 1-16 (2006).

36. *Southland,* 465 U.S. at 16 n.11; F. Paul Bland, Jr., & Claire Prestel, *Challenging Class Action Bans in Mandatory Arbitration Clauses*, 10 CARDOZO J. CONFLICT RESOL. 369, 373 (2009).

37. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996).

38. Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987).

39. Litman v. Cellco P'ship, No. 07-CV-4886(FLW), 2008 WL 4507573 at *1 (D.N.J. Sept. 29, 2008).

40. 511 F.3d 369 (3d Cir. 2007).

41. *Id.* at 374-75, 393 n.17.

42. *Id.* at 375.

43. *Id.* at 390-92.

44. *Id.* at 392-93; *see also* Lytle v. CitiFinancial Servs., Inc., 810 A.2d 643, 665-66 (Pa. Super. Ct. 2002); Thibodeau v. Comcast Corp., 912 A.2d 874, 884-86 (Pa. Super. Ct. 2006).

45. *Gay*, 511 F.3d at 390.

46. *Id.* at 375.

under Virginia law[47] the contract was not unconscionable, meaning the agreement to arbitrate was valid and enforceable.[48]

While clearly dictum, the court stated that even if it was applying Pennsylvania law on unconscionability, the holding would still be the same.[49] The court noted that the two cases cited by the plaintiff did lend support to her claim that the agreement to arbitrate was unconscionable.[50] However, the court stated that the FAA would preempt the Pennsylvania precedent, as the holdings cited by the Plaintiff were inconsistent with the standards set forth in *Southland*.[51] The court found that the two Pennsylvania cases invalidated consumer agreements to arbitrate based upon a public policy that sought to encourage the enforcement of meritorious claims that were cost-prohibitive to pursue individually.[52] In the court's view, the cases reflected a state policy that favored class action, and to hold that waivers of class actions in an contract providing for arbitration are per se unconscionable would be to put arbitration agreements on different footing as other contracts.[53] Thus the court concluded that the founding principles of the two cases were not based upon "grounds [that] exist at law or in equity for the revocation of *any* contract"[54] and did not "reflect a liberal federal policy favoring arbitration agreements."[55] So even if the court used Pennsylvania state law and precedent, that law would be preempted by the FAA because it was in conflict with the substance and goals of section 2 of the FAA.[56]

C. New Jersey Law of Unconscionability and the FAA

While the case of *Littman v. Cellco* was adjudicated in federal court and dealt with federal statutes, the application of New Jersey contract law was an important element of the case.[57]

New Jersey courts may refuse to enforce a contract if it is deemed unconscionable.[58] Courts hold that unconscionability usually entails two factors. One is procedural unconscionability, which can include a variety of inadequacies relating to the person or the contractual negotiation.[59] The second factor is substantive unconscionability, which generally involve harsh or unfair, one-sided terms.[60]

47. The standard for unconscionability in Virginia is very high, as it requires the bargain to be "'one that no man in his senses and not under a delusion would make, on one hand, and as no fair man would accept, on the other.' The inequality must be so gross to shock the conscience." Mgmt. Enters., Inc. v. Throncroft Co., 416 S.E.2d 229, 231 (Va. 1992) (quoting Smyth Bros. v. Beresford, 104 S.E. 371, 382 (Va. 1920)).

48. *Gay*, 511 F.3d at 391-92.

49. *Id.* at 492.

50. *Id.*

51. *Id.* at 393-94.

52. *Id.* at 392-94.

53. *Id.* at 393-94.

54. *Id.* at 394 (quoting Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987) (emphasis in original)).

55. *Id.* at 394 (quoting Johnson v. W. Suburban Bank, 225 F.3d 366, 376 (3d Cir. 2000)).

56. *Id.* at 394-95.

57. Litman v. Cellco P'ship, No. 07-CV-4886(FLW) 2008 WL 4507573 at *1 (D.N.J. Sept. 29, 2008)

58. Saxon Constr. & Mgmt. Corp. v. Masterclean of N.C., Inc., 641 A.2d 1056, 1058 (N.J. Super. Ct. App. Div. 1994).

59. Sitogum Holdings, Inc. v. Ropes, 800 A.2d 915, 902-22. (N.J. Super. Ct. Ch. Div. 2002).

60. *Id.*

When deciding if a consumer contract falls under either type of unconscionability, the courts use a four-factor test, developed in the case of *Rudbart v. North Jersey District Water Supply Commission*,[61] after first determining whether the contract is one of adhesion.[62] New Jersey Courts define a contract of adhesion as a contract presented to consumers on a "take it or leave it" basis, in a standardized form with no real opportunity to negotiate.[63] Once it is determined that the contract in question is one of adhesion, courts will weigh the "subject matter of the contract, the party's relative bargaining positions, the degree of economic compulsion motivating the 'adhering' party, and the public interests affected by the contract."[64]

Muhammad v. County Bank of Rehoboth Beach, Delaware[65] is the leading New Jersey case dealing with the balancing of state unconscionability claims and the FAA. The case involved a plaintiff consumer who brought a class action suit against a lender for violating various state and federal statutes by allegedly charging the plaintiff exorbitant interest rates.[66] The agreement the plaintiff signed had an agreement to arbitrate and a waiver of class action claims, including class arbitration.[67] The defendant bank filed a motion to compel arbitration pursuant to the FAA, which the trial court granted and the appellate court affirmed.[68] The Supreme Court of New Jersey heard the plaintiff's appeal and reversed the decision of the appellate court, holding that the arbitration agreement was unconscionable.[69]

The court stated that U.S. Supreme Court precedent states that the FAA does not preclude a judicial court from determining the validity of an arbitration agreement by using general contract defenses.[70] Once the court laid the foundational authority to review the agreement, the court used the four *Rudbart* factors to determine if the agreement was unconscionable.[71] The court determined that there was evidence to support a finding of unconscionability as to the first three factors—the subject matter of the agreement, the bargaining power, and the compulsion of the parties—because there was a disparity in bargaining power and a high degree of economic compulsion.

The court stated that the most important issue is the public policy question—the fourth factor—and determined that public policy renders the contract unconscionable.[72] The court reasoned that most class action suits involve small claims from consumers who would not be able to exercise their rights individual-

61. 605 A.2d 681 (N.J. 1992).
62. *Id.* at 685-86.
63. *Id.* at 685.
64. *Id.* at 687.
65. 912 A.2d 88 (N.J. 2006).
66. *Id.* at 90-91.
67. *Id.* at 91-93.
68. *Id.* at 94.
69. *Id.* at 100-01.
70. *Id.* at 94-95 (quoting Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 452 (2003) (plurality opinion) (holding that whether parties entered into a valid arbitration agreement is a gateway "question that requires judicial determination"); Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) (stating that "generally applicable contract defenses . . . may be applied to invalidate arbitration agreements without contravening" the FAA)).
71. *Id.* at 98-100.
72. *Id.* at 99-100.

ly.[73] In addition, the purpose of the complete waiver of any kind of class action is a means for companies to insulate themselves from liability, because without class actions, few (if any) consumers would elect to arbitrate their claims individually.[74] Thus, because of the class action waiver, the New Jersey Supreme Court invalidated the agreement for being unconscionable.[75]

*D. Post-*Litman *Developments*

Homa v. American Express presented a very similar situation as *Litman*, but the court reached the opposite conclusion when it held that New Jersey state law regarding unconscionability was not preempted by the FAA.[76] The case started when G.R. Homa filed a class action suit against American Express, claiming the company misrepresented the terms of the company's cash back program and that the company never paid money owed him.[77] The credit card agreement Homa signed contained an agreement to arbitrate any disputes, a class action waiver, and a choice of law provision.[78] American Express filed a motion to compel arbitration, and the district court granted its motion, dismissing the case in favor of individual arbitration.[79] The Third Circuit reversed the decision of the district court, and remanded the case for further proceedings.[80]

During the case, American Express contended that the FAA requires preemption of New Jersey state law, as the court found in *Gay*.[81] The court disagreed, stating that *Gay* does not stand as a "blanket prohibition on unconscionability challenges to class-arbitration provisions."[82] The court held that *Gay* was distinguishable because the case involved laws that disfavored arbitration, whereas the New Jersey law, as applied in *Muhammad*, did not disfavor arbitration and thus was not preempted by the FAA.[83]

The Court in *Homa* found that *Muhammad* did not stand for the proposition that an agreement to arbitrate is unconscionable simply because it is an agreement to arbitrate, a holding that would require preemption by the FAA.[84] Instead, the court read *Muhammad* to allow all general contract defenses and would apply to all class action waivers, not just those in contracts that compel arbitration.[85] To this court, the arbitration agreement in *Muhammad* was unconscionable because it deprived the plaintiffs of any class action mechanism, violating a public policy interest in ensuring consumers are able to pursue their statutory rights when low value claims are involved.[86]

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73. *Id.* at 99.
74. *Id.* at 99-100.
75. *Id.* at 100-01.
76. Homa v. Am. Express, 558 F.3d 225 (3d Cir. 2009).
77. *Id.* at 226-27.
78. *Id.* at 227.
79. *Id.*
80. *Id.* at 233
81. *Id.* at 230.
82. *Id.*
83. *Id.* at 230-31.
84. *Id.*
85. *See id.* at 230.
86. *Id.* at 230, 232

IV. THE INSTANT DECISION

The U.S. District Court for the District of New Jersey began by reviewing the facts, background, and procedural history of the case, and then began an overview of the FAA.[87] The court concluded that established precedent dictates that under the FAA, agreements to arbitrate are valid and irrevocable, unless the agreement violates contract principles applicable to all contracts.[88] The court proceeded to give a brief overview of both *Muhammad* and *Gay*.[89] The court concluded that the sole issue before the court is whether *Muhammad* should be controlling, thus rendering the contract unconscionable, or whether *Muhammad* is contrary to the FAA and should be preempted.[90]

The court interpreted *Gay* to hold that the FAA is controlling when state law interprets an arbitration agreement differently than any other agreement, and therefore the arbitration agreement should be enforced.[91] The court noted that "the Circuit left very little room for this Court to invalidate an arbitration clause on the basis of a class waiver provision, even if it is unconscionable under state law."[92]

The plaintiff attempted to distinguish *Gay*, arguing that the Pennsylvania cases cited in *Gay* were not neutral to arbitration and that *Muhammad* was entirely neutral with respect to arbitration agreements.[93] The court did not find that argument persuasive, as it stated that one of the Pennsylvania cases was seemingly neutral, but the court had to parse the provisions to find only the part of the agreement about arbitration unconscionable.[94] From the court's perspective, the same sort of parsing was at play in *Muhammad*: the court noted that the agreement in *Muhammad* had a broad class action and class arbitration waiver, but the New Jersey court only focused on the class arbitration waiver.[95]

The court contended that the New Jersey court parsed through the contractual provisions to see what the provisions included and ruled it unconscionable for what the contract provided: that is, arbitration over litigation.[96] These factors lead this court to conclude that the New Jersey court treated arbitration agreements differently from other contractual provisions. Because of this discrepancy in treatment of the arbitration agreement, the court felt itself bound by the precedent established in *Gay* and held that the FAA should preempt the New Jersey state law that did not conform with the FAA, and granted the defendant's motion to compel arbitration.[97]

87. Litman v. Cellco P'ship, No. 07-CV-4886(FLW), 2008 WL 4507573 at *1-*2 (D.N.J. Sept. 29, 2008).
88. *Id.* at *2-*3.
89. *Id.* at *3, *4-*6.
90. *Id.* at *4.
91. *Id.*
92. *Id.*
93. *Id.* at *5-*6.
94. *Id.* at *6.
95. *Id.*
96. *Id.*
97. *Id.* at *7.

V. COMMENT

In *Litman,* the district court had the opportunity to distinguish *Gay* and reaffirm the New Jersey state law and principles stated in *Muhammad.* The court could have read *Gay* as standing for the proposition that the FAA will only preempt state law if the law in question legitimately favors a judicial resolution over an arbitral forum. This would be a fair reading of *Gay*, as the Pennsylvania laws at issue did give a preference to a judicial forum.[98]

Instead, the court read *Gay* as holding that a class action waiver can be enforceable under the FAA notwithstanding the generally applicable state contract law defense of unconscionability. This reasoning is clearly demonstrated when the court opined that "the Circuit left very little room for this Court to invalidate an arbitration clause on the basis of a class waiver provision, even if it is unconscionable under state law."[99]

The court also could have read *Muhammad* to hold that the class action waiver was unconscionable because it striped consumers of statutory rights and remedies.[100] Instead the court read *Muhammad* to hold that the class waiver was unconscionable for what it provided—arbitration over a judicial forum—and thus was not consistent with the FAA.[101] However, upon a close reading, it becomes clear that *Muhammad* is consistent with the FAA; that the court misinterpreted the holding of *Muhammad*; and that the court's holding in *Litman* sets a problematic precedent for Third Circuit consumers.

According to the district court, the court in *Muhammad* treated arbitration differently than other contractual provisions.[102] This view does not seem to be in accordance with much of the language and holding within the *Muhammad* opinion. This is laid out in the court's primary holding that "it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, *whether in arbitration or in court litigation.*"[103] Furthermore, the court stated that its holding was consistent with the "New Jersey's public policy favoring arbitration"[104] and that the case was decided "as a matter of generally applicable state contract law."[105] But perhaps the most telling indication that the court does not disfavor arbitration is the fact that, after the court held that the class action waiver was unconscionable, the court directed the class action suit to proceed in the form of class arbitration—not as a judicial class action.[106]

There is also evidence outside the *Muhammad* opinion to indicate that the New Jersey courts do not treat agreements to arbitrate differently than other agreements. On the same day the New Jersey supreme court decided *Muhammad,* the court issued its opinion in *Delta Funding Corp. v. Harris.*[107] In *Delta Funding*, the court upheld a similar class action waiver, directed the case to individual

98. Gay v. CreditInform, 511 F.3d 369, 375 (3d Cir. 2007).
99. Litman, 2008 WL 4507573, at *4.
100. *See* Muhammad v. County Bank of Rehoboth Beach, 912 A.2d 88, 98-104 (N.J. 2006).
101. *Litman*, 2008 WL 4507573 at *6.
102. *Id.*
103. *Muhammad* 912 A.2d at 100-01 (emphasis added).
104. *Id.* at 101.
105. *Id.* at 100-01
106. *Id.* at 101-02
107. 912 A.2d 104 (2006).

arbitration, and stated that "under New Jersey law, the class-arbitration waiver . . . is not unconscionable per se."[108] The court distinguished the two cases, reasoning that the plaintiff in *Delta Funding* was seeking damages in excess of $100,000 and had an incentive to pursue the case, which was to save her house from foreclosure.[109]

This illustrates the fact that New Jersey courts do not hold class wavers unconscionable simply because they provide arbitration instead of a judicial resolution. Instead, regardless of the type of contract provision at play, the court undertakes a unconscionability analysis dependent on a fact-sensitive analysis in each instance, which includes the amount of damages being pursued, other relief available, and the complexity of the issues.[110] The main reason the court in *Muhammad* held the class waiver unconscionable was because it acted as a "remedy stripping" provision, which ultimately would have prevented consumers from litigating their low-value claims.[111]

The Third Circuit affirmed this reading of *Muhammad* in the case of *Homa v. American Express*, where the court held that New Jersey state law regarding unconscionability was not preempted by the FAA.[112] To reiterate, that court held that *Muhammad* clearly did not stand for the proposition that an agreement to arbitrate is unconscionable for the simple fact it is an agreement to arbitrate.[113] Instead, the court viewed the defense provided for in *Muhammad* to be a general contract defense, not just for contracts involving arbitration, but one that would apply to all class action waivers.[114]

The *Homa* court's analysis is in stark contrast to the analysis explicated by the district court in *Litman*. In *Litman,* the court viewed *Muhammed* as treating arbitration agreements differently and held that the FAA should preempt New Jersey state law.[115] The court in *Homa*, however, realized that reasoning behind *Muhammad* was not rooted in hostility towards arbitration, but in the state's interest in ensuring that companies are not allowed to prevent consumers from pursuing valuable claims.[116] For if consumers were forced to pursue their small value claims individually, it would become economically unfeasible for consumers to do so.[117] The *Homa* court realized that enforcement of arbitration agreements and class action waivers in many consumer agreements is not favorable for consumers.

Many legal commentators have argued that mandatory arbitration and broad class action waivers are dissatisfactory for consumers.[118] One of the reasons is

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108. *Id.* at 115.
109. *Id.*
110. *See Muhammad*, 912 A.2d at 100 n.5.
111. Allison Burtka, *Third Circuit Rejects Preemption, Choice of Law in Arbitration Case*, 45 TRIAL 18, 18. (May, 2009).
112. Homa v. Am. Express, 558 F.3d 225, 233 (3d Cir. 2009).
113. *Id.*
114. *Id.* at 227.
115. Litman v. Cellco P'ship, No. 07-CV-4886(FLW), 2008 WL 4507573, *5-*6 (D.N.J. Sept. 29, 2008).
116. *Homa*, 558 F.3d at 230
117. *Id.* at 230-32
118. *See generally* Jean R. Sternlight & Elizabeth J. Jensen, *Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. 75 (2004); Daniel Higginbotham, Note, *Buyer Beware: Why the Class Arbitration Waiver Clause Presents a Gloomy Future for Consumers*, 58 DUKE L.J. 103 (2008); F. Paul Bland, Jr., & Claire

that consumers often know little about the provisions of their agreements.[119] Many consumers do not anticipate litigation and do not realize how valuable their litigation rights are when they agree to arbitrate.[120] Many consumers also may not realize when they are the victims of illegal activity. Without class action, and the ability to alert consumers of potential illegal conduct at the hands of businesses, many potential victims would go without compensation and many of the malefactors would go unpunished.[121] This is another point of contention among critics of arbitration: without any class action mechanism, many valid claims will never be pursued.

Even though it would not allow the class action to proceed, the court in *Litman* admitted that its holding is unfair for the consumer. The court said that compelling individual arbitration was "tantamount to ending the Plaintiffs' pursuit of their claims," noting that there was very little chance that any Plaintiff would individually arbitrate over damages less than $100, and described this outcome as "harsh."[122] The statements of the district court in *Litman* sum many of the arguments against class action waivers. Much of the damage done to each individual consumer is small, but the damage is large when considering all the consumers as a whole. For example, it would not be economically feasible for a consumer who was over-charged $0.50 a month to hire a lawyer and pay the costs associated with arbitration. Many lawyers have testified in cases challenging class action bans that no lawyer would take such a case individually, even if the claim was completely valid.[123] There is also strong support from the U.S. Supreme Court for the proposition that class actions are necessary to ensure an adequate remedy for those with small claims.[124] If consumers are not allowed to aggregate their small claims, they will not be able to obtain the proper compensation and businesses will continue to profit from their wrongful conduct.

Even if a consumer decides to and is able to pursue a case in arbitration, there is evidence that would suggest the process itself is unfair. While the secret nature of arbitration makes it difficult to get a full statistical picture, the available numbers do not show the process as favorable to consumers. Data made public in California show that one of the nation's largest arbitration firms, the National Arbitration Forum (NAF), ruled against consumers in ninety-five percent of its California cases.[125]

There is also concern about the connection between arbitration firms and the companies that frequently use them.[126] Consumer advocates fear that arbitrators will be inclined to rule favorably for companies who frequently use their services.

Prestel, *Challenging Class Action Bans in Mandatory Arbitration Clauses*, 10 CARDOZO J. CONFLICT RESOL. 369 (2009).

119. Bland & Prestel, *supra* note 118, at 386.

120. Higginbotham, *supra* note 118, at 117.

121. Sternlight & Jensen, *supra* note 118, at 88-89.

122. Litman v. Cellco P'ship, No. 07-CV-4886(FLW), 2008 WL 4507573, at *7 n.6 (D.N.J. Sept. 29, 2008).

123. Sternlight & Jensen, *supra* note 118, at 87.

124. Bland & Prestel, *supra* note 118, at 378.

125. Paul Wenske, *When You Sign up for a Credit Card, You Sign Up for Arbitration*, KANSAS CITY STAR, Oct. 6, 2007, *available at* http://www.freerepublic.com/focus/f-chat/1907924/posts.

126. Carrick Mollenkamp, Dionne Searcey, & Nathan Koppel, *Turmoil in Arbitration Empire Upends Credit Card Disputes*, WALL STREET JOURNAL, Oct. 15, 2009, at A14. *available at* http://online.wsj.com/article/SB125548128115183913.html.

Former NAF arbitrator and Harvard Law Professor Elizabeth Bartholet gave some credence to those concerns when she testified before Congress.[127] She claimed that she had ruled in favor of credit card companies in eighteen straight decisions, only to have NAF stop sending her cases shortly after she ruled in favor of a consumer.[128]

A recent study, using available data from NAF, backed up Bartholet's claims. The study showed that NAF's ten most used arbitrators, who arbitrated sixty percent of the cases, only ruled in favor of consumers 1.6 percent of the time, as opposed to arbitrators who arbitrated fewer than three cases, who ruled in favor of consumers thirty-eight percent of the time.[129] While these numbers represent a small sample of the total number of arbitration cases, they are enough to suggest that arbitration is a forum that is not favorable to consumer claims.

VI. CONCLUSION

The district court in New Jersey held that the state's law on unconscionability did not conform to the federal guidelines given in the FAA. Therefore the court held that Third Circuit precedent controlled over state law, and granted Verizon's motion to compel arbitration. There are serious questions as to the prudence of this ruling. The court seemed to misinterpret the holding in *Muhammad* as being in conflict with the FAA. However, the holding in *Muhammad* is consistent with the defenses allowed by the FAA and should not have been preempted. This idea was validated by the Third Circuit when it held in *Homa* that New Jersey law on unconscionability is not unfavorable to arbitration and should not be preempted by the FAA.

Furthermore, the district court failed to consider New Jersey's public policy against class action waivers, as individual arbitration can strip consumers of remedy, allow the continued abuse of consumers at the hands of large corporations, and appears to be a forum that is unfavorable to consumers. The Third Circuit will have an opportunity to correct the mistakes of the district court, as the *Litman* plaintiffs have their appeal docketed for this year. A reversal of the district court's decision will go a long way to correct the erroneous analysis undertaken by the district court and protect consumers by ensuring that they have a right to pursue valid claims that would otherwise not be feasible if the holding in *Litman* is affirmed.

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127. *Id.*
128. *Id.*
129. Richard Alderman, *Why We Really Need the Arbitration Fairness Act*, 12 J. CONSUMER & COM. L. 151, 155 (2009).